

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

PERIODIC REPORTING)
(PROPOSAL EIGHT)) Docket No. RM2017-12

RESPONSE OF
ALLIANCE OF NONPROFIT MAILERS
TO REPLY COMMENTS OF UNITED STATES POSTAL SERVICE

(October 3, 2017)

The Alliance of Nonprofit Mailers (“ANM”) respectfully submits this response to the unauthorized reply comments filed the Postal Service on September 26.¹ The Postal Service’s reply comments merely underscore the lack of any good reason to abandon the interpretation of 39 U.S.C. § 3626(a)(6) that the Postal Service persuaded the Commission to adopt in R2008-1, and which the Postal Service and the Commission have consistently applied since then.

I. The Postal Service Concedes That Applying The 60 Percent Ratio At The Class-Average Level Complies With 39 U.S.C. § 3626(a)(6).

The Postal Service disavows any claim that “continued application of the [60 percent] standard at the overall class level would ‘violate’ the statute,” or that the Postal Service’s “preferred return to application of the standard at the subclass level ‘is required.’” USPS Reply Comments at 2. The Postal Service could hardly do otherwise.

¹ ANM asks the Commission to accept this filing if the Commission accepts the Postal Service’s reply comments. See Response of ANM to Motion of USPS for Leave to File Reply Comments Regarding Proposal Eight (filed separately today).

The Commission has held repeatedly in its annual compliance determinations under 39 U.S.C. § 3653(b) that the relationship between nonprofit and commercial Standard Mail revenue resulting from application of the 60 percent standard at the classwide level was “in compliance with all of the preferred rate requirements identified in 39 U.S.C. § 3626.”²

The Postal Service has consistently taken the same position until this case. The concept of applying the 60 percent ratio at the classwide level after the enactment of PAEA originated with the Postal Service itself. ANM Comments at 9 (quoting Docket No. R2008-1, USPS Notice of Market Dominant Price Adjustment (Feb. 11, 2008) at 24-25). In early 2009, after Valpak pointed out in ACR2008 that classwide application of the 60 percent ratio produced lower nonprofit rates than would applying the 60 percent ratio separately to regular and ECR Standard Mail, the Postal Service reemphasized that interpreting 39 U.S.C. § 3626(a)(6) by “applying [the 60 percent ratio] at the class level ... fully achieves the purposes of that provision.” USPS reply comments in ACR2008 (Feb. 13, 2009) at 30-32.

The Postal Service has continued to support classwide application of the 60 percent ratio in every Annual Compliance Review proceeding since ACR2008. To establish that nonprofit Standard Mail has “complied with all applicable requirements” of Title 39, as 39 U.S.C. § 3652(a)(1) requires, the Postal Service has consistently represented to the Commission that nonprofit Standard Mail rates have satisfied 39

² Annual Compliance Determination, Fiscal Year 2013, at 39; Annual Compliance Determination, Fiscal Year 2014, at 32; Annual Compliance Determination, Fiscal Year 2015, at 41; Annual Compliance Determination, Fiscal Year 2015, at 41; *accord*, Annual Compliance Determination, Fiscal Year 2013, at 39; Annual Compliance Determination, Fiscal Year 2012, at 124-25.

U.S.C. § 3626(a)(6) because the average nonprofit and commercial revenue per piece have achieved the required 60 percent ratio *at the class average level*.³

II. The Postal Service Has Failed To Provide Any Valid Policy Justification For Reverting To The Pre-PAEA Interpretation Of Section 3626(a)(6).

The Postal Service's case for jettisoning the longstanding interpretation of Section 3626(a)(6) thus rests solely on an appeal to Commission discretion. To paraphrase the Postal Service, both the class-average and the "subclass"-specific application of the 60 percent ratio comply with the statute, but the latter approach would produce better results. As the Postal Service acknowledges, however, established agency standards should not be changed without a reasoned justification. USPS Reply Comments at 11-2 (quoting *Nuclear Energy Inst., Inc. v. EPA*, 373 F.3d 1251, 1296 (D.C. Cir. 2004)); *accord* ANM Comments at 12-13 (citing precedents). None of the policy arguments for change offered by the Postal Service satisfy this burden.

The Postal Service offers essentially four arguments: (a) applying the 60 percent ratio at the class-average level gives nonprofit mailers a "windfall" because the class-average approach produces lower nonprofit rates than does applying the 60 percent ratio at the "subclass" level; (b) the Postal Service was too busy to notice this fact when proposing the class average approach in R2008-1, so the Commission should disregard the Postal Service's previous support for the approach; (c) the effective ratio of nonprofit-to-commercial Marketing Mail rates has drifted down further *since* the R2008-1 change in

³ USPS FY 2011 Annual Compliance Report (Dec. 29, 2011) at 1, 21; USPS FY 2012 Annual Compliance Report (Dec. 28, 2012) at 1, 14; USPS FY 2013 Annual Compliance Report (Dec. 27, 2013) at 1, 18; USPS FY 2014 Annual Compliance Report (Dec. 29, 2014) at 1, 18; USPS FY 2015 Annual Compliance Report (Dec. 29, 2015) at 1, 16; USPS FY 2016 Annual Compliance Report (Dec. 29, 2016) at 1, 24.

methodology for a variety of reasons, and reverting to the pre-2008 approach would help offset this “windfall”; and (d) any “rate shock” or other harms that nonprofit mailers might suffer from the proposed change of interpretation does not offset its benefits. We respond to each argument in turn.

(A)

The Postal Service’s main rationale for jettisoning the current interpretation of Section 3626(a)(6) is that the switch in R2008-1 to classwide application of the 60 percent ratio has produced, and will continue to produce, “different” (i.e., lower) nonprofit rates than would applying the ratio separately to regular and ECR mail. USPS Reply Comments at 4 (“the fundamental problem with the existing approach is that it produces *different* nonprofit rates” than would “applying the 60 percent ratio separately to regular and ECR mail”); *id.* at 15 (referring to “windfall benefits of the class level approach”); see *generally id.* at 4-15. ANM does not dispute that the class-average application of the 60 percent ratio produces different nonprofit rates than would a more disaggregated approach. But this has been true in every year since 2000, and was readily apparent in 2008, when the Postal Service proposed the class average approach and the Commission adopted it. ANM Comments at 13-14 & Table 2. Simply noting the difference between the two approaches begs the question of why one is better than the other.

This is hardly an obscure or trivial question, particularly in light of the Postal Service’s previous consistent support for the class-average approach adopted in R2008-1. The Postal Service’s reply comments in Docket No. ACR2008 are telling in this regard. In response to Valpak’s observation that applying the 60 percent ratio in a more

disaggregated way would produce higher nonprofit rates, the Postal Service doubled down on its support for applying the ratio at the class level:

Valpak's comments also raise the issue of how the nonprofit / commercial unit revenue ratio of section 3626(a)(6) is calculated. Valpak Comments at 55-58. While Valpak is careful to point out that it is not taking a position on this issue, it does "recalculate" nonprofit / commercial ratios at the product level, as opposed to the class level. Valpak's reason for doing so is to make the narrow point that a product-level application of section 3626(a)(6) would increase the calculated cost coverage for the High/Density and Saturation products.

The *proper* calculation of this ratio was first addressed in Docket No. R2008-1. In that case, the Postal Service *expressed its view* that the appropriate successor to the "subclasses" mentioned in the statute should be the Standard Mail class as a whole. The Commission accepted this interpretation as being consistent with the law, both in its review of the Postal Services' new prices, and later in the FY 2007 ACD. See Order No. 66 at 32; FY 2007 Annual Compliance Determination at 87-88.

Valpak's discussion of this issue, simply to make its narrow point concerning the cost coverage for the products it is interested in, should not entice the Commission to reconsider its acceptance of the class-level approach. A review of section 3626(a)(6) shows that it was not updated when the PAEA was passed: it not only uses the term "subclasses," which has been replaced in the new regulatory structure with the "products," but also refers to the "factors" of section 3622(b), whereas that section lays out "objectives" (the "factors" are set forth in section 3622(c)). Thus, the question becomes how to apply this language to the new pricing structure, in a way that best effectuates the purposes of that provision, in light of the new regulatory principles. *While calculating the ratio at the product level may help Valpak to make its point, it could constitute bad business policy in the long run.*

For instance, whereas the creation of new subclasses was a rare event during the PRA regime, encompassing as they did relatively large groupings of mail, the creation of new products may be less rare. For example, new Standard Mail products may be added, in order to recognize

important market segments, such as through niche classifications. Applying the ratio to smaller and smaller groupings of mail would rob the Postal Service of needed pricing flexibility and potentially lead to highly undesirable outcomes. Consider a niche product that consists of a group of mail with a low cost coverage (though not necessarily a low unit contribution). In such a circumstance, section 3626(a)(6), if applied at the product level, could require the Postal Service to set nonprofit prices at economically unwise levels. This situation could also occur within the context of the current product makeup of Standard Mail. For instance, the FY 2008 ACR shows that the Parcels / NFM's product currently does not cover its costs. Were subsequent price increases to raise this cost coverage to, say, 125 percent, interpreting section 3626(a)(6) as requiring that nonprofit Parcels / NFM's have an average revenue that could not exceed 60 percent of commercial Parcels / NFM's would almost certainly guarantee that most, if not all, nonprofit Parcels / NFM's would fail to cover their costs, which is not consistent with the Postal Service's business interest in having its costs covered. Clearly, it is superior to *interpret section 3626(a)(6)* in a way that precludes such an outcome, *by applying it at the class level*, when such an interpretation *fully achieves the purposes of that provision*.

USPS reply comments in ACR2008 (Feb. 13, 2009) at 30-32 (emphasis added).

The Postal Service's reply comments in ACR2009 thus identified three separate grounds for applying the 60 percent ratio at the class average level rather than at a more disaggregated level: (1) elimination of subclasses for ratemaking by PAEA in 2006 made the prior subclass-level approach anachronistic; (2) applying the 60 percent ratio at the class average level "fully achieves the purposes of" Section 3626(a)(6); and (3) applying the 60 percent ratio at a more disaggregated level could lead to "highly undesirable outcomes." The Postal Service has failed to offer any reasoned basis in the current docket for finding that these policies no longer hold.

(B)

The same facts also dispose of the Postal Service's attempt to brush off as an oversight its longstanding support for applying the 60 percent ratio at the class level. *Cf.* USPS Reply Comments at 4-5, 11 (asserting that the Postal Service was too busy implementing the "PAEA regime" in R2008-1 to notice that applying the 60 percent ratio at the class level produced lower nonprofit rates than applying the ratio separately for regular and ECR mail). As explained above, the Postal Service continued to support application of the 60 percent ratio at the class average level after being put explicitly on notice by Valpak in ACR2008 that a more disaggregated approach would yield higher nonprofit rates. And the Postal Service continued to support the class-average application of the 60 percent ratio in each of the Postal Service's annual compliance reports filed under 39 U.S.C. § 3652 through Fiscal Year 2016. See pp. 2-3, *supra*.⁴

(C)

The Postal Service, obviously recognizing the awkwardness of attacking as unsound the very interpretation of the 60 percent ratio that the Postal Service persuaded the Commission to adopt in R2008-1, suggests in its reply comments that reverting to the pre-2008 interpretation of the 60 percent ratio would be a good way to offset the "windfall benefits" allegedly conferred by the supposed *deepening* in the rate preference received

⁴ In any event, the notion that the Postal Service was too busy to notice this relationship even in R2008-1 is implausible. That class average application of the 60 percent ratio produced lower nonprofit rates than did application of the ratio at the "subclass" level was and is readily apparent from billing determinants and the Postal Service's own price cap compliance library references. Postal Service library reference USPS-RM-2017-12/1 in the present case also provides a straightforward calculation of the nonprofit-to-commercial ratios documented for every year dating back to FY 2000.

by nonprofit Standard Mail “in the period *after* the switch to the total class ratio method.” USPS Reply Comments at 9-15. The Postal Service, however, has made no showing that the effects of applying the 60 percent ratio at the class-average level rather than the “subclass” level have changed since the Commission adopted the Postal Service’s proposal in R2008-1. All of the comparisons offered by the Postal Service in its reply comments are based on starting periods that predate R2008-1; the resulting comparisons thus do not show changes occurring since the change in methodology.

As ANM showed in its initial comments, the relationship between average nonprofit and commercial revenue per piece has been remarkably stable since the initial change in methodology in R2008-1. Indeed, between FY 2009 (the first full year in which rates were based on the R2008-1 approach) and the current (R2017-1) rates, the percentage increase in nonprofit and commercial average revenue per piece (a measure highlighted in the Postal Service’s reply comments) has been virtually identical, 2.8 percent. ANM comments at 10-11 and Library Reference ANM-RM2017-12/1.⁵ Limiting the comparison to the period *since* R2008-1 is thus not a “trick” (*id.* at 5-6) but an essential requirement for any meaningful comparison of changed circumstances. The straw man in this debate is the Postal Service’s attempt to pass off the known effects of the original change in methodology as a later change in circumstances.

⁵ The Commission can obtain the same result from the Postal Service’s own workpapers. The percentage increase in commercial average revenue per piece is calculated by dividing cell M17 of “RM2017-12 Ratios” of Ratio History.xlsx from USPS-RM2017-12/1 by cell M49 from the same worksheet and subtracting 1. The percentage increase in nonprofit average revenue per piece is calculated by dividing cell N17 of “RM2017-12 Ratios” of Ratio History.xlsx from USPS-RM2017-12/1 by cell N49 of the same worksheet and subtracting 1.

The Postal Service's comparison of nonprofit-vs.-commercial rate changes for a selected subset of Marketing Mail, letter mail, is also illegitimate. *Cf.* USPS Reply Comments at 7. No one—not even the Postal Service—has suggested that 39 U.S.C. § 3626(a)(6) requires that the 60 percent ratio be applied individually to any shape category within Marketing Mail.

In this regard, the lack of support for Proposal Eight by most commercial users of Marketing Mail, the putative victims of the current interpretation of Section 3626(a)(6) under the Postal Service's theory, is telling. The two most broad-based associations of commercial direct mailers are PostCom and DMA. PostCom has taken no position on Proposal Eight, and DMA opposes it outright as a “backward step” that “sets a dangerous precedent.” Joint Comments of DMA Nonprofit Federation and the Data & Marketing Association (Sept. 18, 2017).

(D)

The Postal Service does not seriously dispute that the price increases resulting from adoption of Proposal Eight would inflict “budget consequences”—*i.e.*, rate shock—on nonprofit mailers. USPS Reply Comments at 13.⁶ That even larger price increases could result in even more severe rate shock (USPS Reply Comments at 13-14) does not

⁶ The Postal Service's assertion that nonprofit mailers have not taken any “major actions” “in reliance on the” existing interpretation of Section 3626(a)(6) is refuted by the extraordinary volume of comments and letters filed by individual nonprofit organizations in this docket. Nonprofit organizations have made program commitments to their members and the American public in reliance on the assumption that the costs of fundraising by direct mail will not increase significantly faster than inflation. As the comments show, Proposal Eight would cause sizeable increases in fundraising costs, and force curtailment of mission-related activities. This will occur when the nonprofit sector is under greater financial stress than in 2008.

justify ignoring the significant harms that Proposal Eight would cause. And the Postal Service's rejoinder that concerns about rate shock should be downplayed because these concerns "would militate against any increase in nonprofit rates, regardless of the basis" (*id.* at 13 n. 5), is an attack on a straw man. ANM does not contend that avoidance of rate shock inevitably outweighs all other ratemaking considerations. But the justification for a change in ratemaking principles must be stronger when the change would cause rate shock, particularly when the existing price standards are lawful, and the arguments for changing the standards are merely prudential.⁷

The Postal Service also concedes that the Postal Service could manipulate nonprofit-vs.-commercial rate relationships through classification changes if the 60 percent standard were applied at the "subclass" level. USPS Reply Comments at 3 n. 2. The Postal Service's denial that it has "any practical incentive" to exploit this opportunity for abuse, *id.*, is of no comfort to nonprofits. The Postal Service has a long history of proposing rates and classifications that discriminate against nonprofits without any practical economic benefit to the Postal Service. See, e.g., *National Easter Seal Society v. USPS*, 656 F.2d 754, 760-62 (D.C. Cir. 1981) (discrimination in offering presort discounts for Third-Class Mail); Order No. 731 in Docket No. R2011-5, *Notice of Market Dominant Adjustment for First-Class Mail and Standard Mail* (May 17, 2011) at 8-9 (discrimination in proposed discounts for mobile barcodes); Order No. 1573 in Docket No. R2013-1, *Notice of Market-Dominant Price Adjustment* (Dec. 11, 2012), at 8-9, petition

⁷ The Postal Service has repeatedly invoked claims of rate shock in recent years as a justification for delaying the reduction of worksharing discounts that arguably violate 39 U.S.C. § 3622(e). See, e.g., *Annual Compliance Determination, Fiscal Year 2013* (March 27, 2014) at 27. *A fortiori* concerns of rate shock merit greater weight here, where the Postal Service concedes that the existing rate relationships comply with the statute, and the only arguments for change are policy arguments.

for review filed *sub nom. Alliance of Nonprofit Mailers v. PRC*, No. 13-1006 (D.C. Cir.) (discrimination in worksharing discounts)⁸; Order No. 2378 in Docket No. R2015-4, *Notice of Market Dominant Price Adjustment* (March 6, 2015), explained, Order No. 2396 (March 17, 2015) at 2 (noting that the Commission “remanded the proposed Standard Mail price adjustments,” *inter alia*, to require the Postal Service to “equalize the nonprofit and commercial High Density letters and High Density Flats presort discounts” and “equalize or provide a justification for the unequal nonprofit and commercial dropship discounts”).

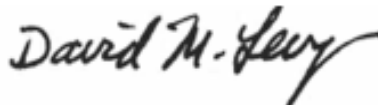
Indeed, the very existence of Proposal Eight itself underscores the Postal Service’s willingness to take actions that harm nonprofit mailers without “any practical incentive” for doing so. By definition, the expected additional nonprofit postal revenue generated by Proposal Eight would have to be offset by reductions in commercial Marketing Mail rates, leaving the Postal Service with no net economic benefit. Yet the Postal Service has obviously devoted substantial resources to developing the proposal, and persists in advocating it despite widespread opposition to it from the Postal Service’s nonprofit customers, and only isolated support from the Postal Service’s commercial customers.

⁸ ANM withdrew its petition for review after the Postal Service settled the case by committing to remedy the discrimination and the Commission approved the terms of the settlement in Docket No. ACR2012, *Annual Compliance Determination, 2012* (March 28, 2013) at 24-25.

CONCLUSION

The Commission should reject Proposal Eight and continue adhering to its 2008 interpretation of 39 U.S.C. § 3626(a)(6).

Respectfully submitted,

A handwritten signature in black ink that reads "David M. Levy". The signature is written in a cursive, flowing style.

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